

**An Intellectual Capital Perspective of Non-profit Strategy:
A Strategic Advantage Conceptual Framework**

By

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Word Count: 3282 words

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Abstract

Very little systematic research has focused on applying the concept of intellectual capital (IC) within the non-profit context; particularly in the highly competitive non-profit environment. This paper firstly contributes to filling this gap by building a nascent body of literature arguing that IC can be utilised as a non-profit strategic concept in the unique non-profit environment. Secondly, an IC conceptual model is proposed in the paper which helps non-profit managers to visualise the importance of strategic advantage in the knowledge-based economy. Finally, the paper discusses how the IC conceptual framework can be effectively utilised to foster strategic advantage in the non-profit sector.

Keywords: Intellectual capital; non-profit strategy; strategic advantage; knowledge-based economy

Introduction

In today's knowledge-based economy, organisations must leverage the knowledge available to them to gain strategic advantage in the marketplace (Kong and Thomson, 2006). Strategic advantage is used to describe an organisation's ability to utilise its dynamic and unique resources that determine its strategic renewal in the competitive environment (Chaharbaghi and Lynch, 1999). Knowledge is commonly recognised as a key strategic resource that an organisation must acquire and sustain overtime in the knowledge-based economy, which can lead to strategic advantage for the organisation (Ambrosini and Bowman, 2001, Mertins *et al.*, 2001, Zack, 2005).

IC represents the collective knowledge that is embedded in the personnel, organisational routines and network relationships of an organisation (Bontis, 2002). IC is therefore applicable to any organisation regardless of whether it is profit oriented or not (Kong, 2003). In the case of non-profit organisations (NPOs), when the level of IC (collective knowledge) is increased, non-profit managers are likely to enhance their ability to make better decisions. Improved decision making can enhance organisational performance (Miller and Lee, 2001). Thus IC is an important resource that NPOs need to develop in order to gain sustained strategic advantages. Previous research has already been conducted to link learning and innovation in the pursuit of competitive advantage in NPOs (Weerawardena and Sullivan-Mort, 2001, Jaskyte and Kisieliene, 2006, Eadie, 1997). This paper attempts to supplement the previous research suggesting that through a thorough understanding of the IC concept, NPOs can take advantage of the knowledge-based economy and increase their effectiveness in serving their stakeholders. In other words, IC helps NPOs to foster strategic advantage in the competitive non-profit environment.

The original contribution of the paper is threefold. Very little systematic research has utilised the concept of IC as a conceptual framework in the highly competitive non-profit environment. This paper contributes to filling this gap by building a nascent body of literature arguing that IC can be utilised as a non-profit strategic advantage concept in the unique non-profit context. Secondly, an IC conceptual framework is proposed in the paper which helps non-profit managers to visualise the importance of IC and strategic advantage in the knowledge-based economy. Finally, the paper discusses how the IC conceptual framework can be effectively utilised to foster strategic advantage in NPOs.

The paper firstly provides a review of the changing role of NPOs in the knowledge-based economy. This is followed by a brief overview of the IC literature and its implications in the non-profit context. Then this prompts to a discussion of the IC conceptual framework and strategic advantage in the non-profit context. Finally, the paper will conclude how the framework can be effectively utilised to foster strategic advantage in NPOs.

The changing role of NPOs in the knowledge-based economy

Prior to the 1980s as the backbone of a government's social service¹ delivery, NPOs enjoyed monopolies by gaining financial support through grants from government (Alexander, 1999, Kearns, 2000). However, since then non-profit sector has been subject to a series of rapid and far-reaching changes (Hudson, 1999, Courtney, 2002, Kearns, 2000).

The major reason for such changes could be traced back to the introduction of new public management (NPM) which was a reform agenda firstly aimed at restructuring the public sector according to private sector principles but this has dramatically altered the

values and methods that traditionally characterised the non-profit sector (Ramia and Carney, 2003, Ryan, 1999, Alexander, 1999, , 2000). Substantial functions which previously operated by government agencies were transferred to NPOs under NPM as the state-run organisations were perceived to be incapable of meeting clients' and the public's changing needs (Hudson, 1999, Courtney, 2002). This has resulted in a major growth in the number and scale of NPOs activities (Salamon *et al.*, 1999, McMurtry *et al.*, 1990). In addition to the government's intentions to utilise competitive tendering and contracting out strategies to foster organisational efficiency and effectiveness in the non-profit sector, NPOs now regularly find themselves sharing the same territory with organisations from public and private sectors, sometimes as collaborators, but perhaps more often as competitors (Ryan, 1999, Weisbrod, 1997).

The notion of competitive advantage has become a commonly accepted rationale for how firms can create and maintain extraordinary performance. NPOs are now expected to adopt for-profit competitive strategy concepts and moving towards a competitive posture (Dees *et al.*, 2001, Weerawardena and Sullivan-Mort, 2001, Terry, 1998). Like any organisation, a NPO gains competitive advantage when it consistently outperforms its competitors. The resources that are pursued by NPOs may include human resources, financial resources, capital resources, administrative resources, physical resources, technological resources and natural resources (Porter and Kramer, 2002). As physical assets and financial capital are no longer the resources that facilitate competitive advantage in the knowledge-based society, knowledge becomes the only differentiating factor for competitive advantage in any organisation (Allee, 1999, Wall *et al.*, 2004, Kaplan and Norton, 2001, Teece, 2002).

Chaharbaghi and Lynch (1999) argue that competitive advantage, which focuses on an analysis of the existing of resources in an organisation, is not sufficient to answer ceaselessly calls of a new generation of resources in a dynamic environment that constantly shifts and evolves. Chaharbaghi and Lynch's description of the dynamic environment also applies to NPOs. Since NPOs are now competing for public support and limited resources with organisations within and across the sector for volunteers, employees, funding and donations (Ryan, 1999), they are required to utilise their existing resources and generate new resources effectively. As can be illustrated in Figure 1, NPOs are consistently required to balance the usage of existing resources and generation of new resources for achieving organisational objectives and social mission.

Insert Figure 1 here

Strategic advantage, on the other hand, provides organisations with the unique ability to develop strategic directions that create new opportunities and shape the future of their competitive environment and thus, strategic advantage encompasses a broader perspective than competitive advantage (Chaharbaghi and Lynch, 1999). Accordingly, organisations have to utilise their resources to An Organisation for Economic Co-operation and Development (OECD) report, *The Knowledge-Based Economy*, clearly states that "The determinants of success of enterprises, and of national economies as a whole, is ever more reliant upon their effectiveness in gathering and utilising knowledge" (OECD, , 1996). Accordingly, knowledge becomes a critical strategic resource that organisations must acquire and sustain in order to gain strategic advantage.

The notion that knowledge is a critical strategic resource also applies to NPOs. As NPOs no longer enjoy monopolies as the sole service providers in the non-profit environment, they urgently require, as what Salamon (1996, p.13) describes, a “new settlement” to assist them to develop a strategic direction that creates new opportunities for their organisations and shape the future of competitive non-profit environment that they will operate in the years ahead. This paper argues that IC can be one of the bases for such a new settlement.

Intellectual capital (IC) and its components

Edvinsson and Malone (1997, p.44) define IC as “the possession of knowledge, applied experience, organisational technology, customer relationships and professional skills that provide ... a competitive edge in the market”. Following the work of a number of scholars in the field of IC, IC encompasses three primary interrelated non-financial components: human capital (HC), structural capital (SC) and relational capital (RC) (Bontis, 1998, Stewart, 1997, Roos *et al.*, 1997).

HC includes various human resource elements, including attitude, competencies, experience and skills, tacit knowledge and the innovativeness and talents of people (Choo and Bontis, 2002, Roos and Jacobsen, 1999). Since it represents the tacit knowledge embedded in the minds of people in organisations (Bontis, 1999, Bontis *et al.*, 2002), HC is important to organisations as a source of innovation and strategic renewal (Bontis *et al.*, 2000, Bontis, 2002, Webster, 2000). Thus, a higher level of HC is often associated with greater productivity and higher incomes or compensation (Wilson and Larson, 2002).

RC characterise an organisation's formal and informal relations with its external stakeholders and the perceptions that they hold about the organisation, as well as the exchange of knowledge between the organisation and its external stakeholders (Grasenick and Low, 2004). RC is important to an organisation because it acts as a multiplying element creating value for the organisation by connecting HC with other external stakeholders (Ordóñez de Pablos, 2004).

The pool of knowledge from the learning and knowledge enacted in day-to-day activities that remains in an organisation at the end of the day after individuals within the organisation have left, represents the fundamental core of SC (Grasenick and Low, 2004, Roos *et al.*, 1997). SC becomes the supportive infrastructure for HC and RC. It includes all of the non-human storehouses of knowledge in organisations such as databases, process manuals, strategies, routines, organisational culture, publications, and copyrights which creates value for organisations, thus adding to the organisations' material value (Bontis *et al.*, 2000, Ordóñez de Pablos, 2004).

Although the IC concept was first developed as a framework to analyse the contribution of intellectual resources in for-profit organisations, the concept is as applicable to NPOs (Kong, 2003). In the case of NPOs, IC is regarded as intellectual resources that enhance efficiency within the organisations for achieving commercial objectives and social mission.

IC and its implications to NPOs

IC is capable of adapting to the challenges posed by NPM because some of the theoretical roots of IC come from the internal focus associated with core competence theory (Mouritsen *et al.*, 2005). IC helps to shift NPOs' strategic focus to intellectual

resources including knowledge, skills and experience. This is important to NPOs because strategic activities and changes that are brought to the organisations will be mainly driven by internal initiatives by paid employees and volunteers rather than external forces such as government agencies. Therefore, resistance to those strategic activities and changes by volunteers and employees is likely to be lowered.

IC relates to questions about identity, such as “who you are, and what you want to be” (Mouritsen *et al.*, 2005, p.12) and thus, IC is not merely an objective in relation to intellectual resources, but an identity crafted around ability and knowledge of what an organisation can do (Roos *et al.*, 1997, Mouritsen *et al.*, 2005). Further, IC is concerned with the control and alignment of human and non-human knowledge flow across organisational levels in order to create value for organisations (Choo and Bontis, 2002, Petty and Guthrie, 2000). This conceptualisation stresses the internally generated, historically forged efficiencies that have a long term horizon through the knowledge, skills talents and know-how of individuals not only in for-profit organisations (Mouritsen *et al.*, 2005, Bukh *et al.*, 2002), but also in NPOs.

IC helps NPOs to avoid goal displacement and resource diffusion. It also assists them to refocus their objectives on the social dimensions, which are sometimes distorted by operating in commercial contract environments. In other words, IC is capable of advising NPOs when to do the right things and how to do things right concurrently. As a result, the IC concept forces non-profit managers to rethink their mission and their social reasons for existence (Kong and Thomson, 2006).

IC is important to NPOs because it helps to create changes in people’s behaviour and values. Roos (1998) argues that although IC may superficially be concerned with sales growth and value creation, it has a deeper purpose.

The deeper purpose of an IC approach is to change people's *behaviour*, not least through changing the corporate language. The concept of IC brings with it *a whole set of new values* about what is good and what is bad management, what is the right and the wrong things [sic] to do in corporations [emphasis added] (Roos, 1998, p.151).

On the contrary, failing to account for IC may lead to a misallocation of intellectual resources and run the risk of making poorly informed decisions, which lead to weak strategic planning processes, high employee turnover, inadequate training and development, inexperienced top management teams, and inability to turn data into information in NPOs. In short, IC becomes a valid strategic advantage conceptual framework to work with NPM drivers.

For over two decades, the attention of the non-profit sector has largely leaned towards financial measurement as a result of NPM. Commercialisation has increasingly become a key focus in many NPOs. The shift has dangerously threatened the social mission of the organisations. This paper takes an initial step to propose an IC conceptual framework which helps non-profit managers to visualise the importance of knowledge as a strategic resource in NPOs. The framework also explains how strategic advantage can be obtained through the utilisation of knowledge in the organisations. An IC conceptual framework and strategic advantage in NPOs is shown in Figure 2.

Insert Figure 2 here

An IC conceptual framework and strategic advantage in NPOs

As can be seen in Figure 2, HC, RC and SC frequently interact with each other and that interactions between the three types of IC create value for NPOs; that is to reconcile commercial objectives for organisational survival and social mission to meet client needs. In other words, IC assists the organisations in their attempts to reconcile their social and commercial objectives under NPM.

HC is important to NPOs because NPOs are accountable to multiple constituents. When dealing with a variety of stakeholders with different expectations, the capabilities of non-profit leaders and managers to deal with accountability and responsiveness to stakeholders' needs and the public interest become important (Balser and McClusky, 2005). NPO stakeholders can be divided into internal and external stakeholders. Depending on the organisations, internal stakeholders include board members, staff and volunteers while external stakeholders are donors, funding providers, potential allies, the media, public sector and other players who are interested in the non-profit operations. As Wallis and Dollery (2005, p.488) argue "[w]hile these relationships are clearly important within NPOs, it would seem that their performance depends most crucially on the quality of leadership exercised at the top by their presidents, CEOs, or executive directors". HC is accordingly significant to NPOs since it helps to align various stakeholders' expectations with the organisations' missions and values.

SC plays an essential role in facilitating internal and external stakeholder relations in NPOs. NPOs are embedded in an inter-connected network of external stakeholders. Effective management is likely to enhance their effectiveness (Balser and McClusky, 2005). To cultivate relationships with a variety of stakeholders with different expectations, Ospina, Diaz, and O'Sullivan (2002) suggest that formal and informal

mechanisms should be employed to develop channels for two-way communication between NPOs and their stakeholders. Such mechanisms may include organisational culture, missions, values, employee satisfaction surveys, and newsletters.

RC is deemed to be critical to NPOs. External relations have always been crucial to NPOs since they rely heavily on outside funding, volunteer support, alliance partnerships and public trust for legitimacy (Balser and McClusky, 2005, Alexander, 1998). For-profit organisations also find that their partnerships with NPOs can be an efficient means of building morale and maintaining good relations in their communities (Young, 1999). Such partnerships may include an allied marketing strategy. For NPOs, with the increase in collaborative arrangements with organisations from other sectors (Ryan, 1999, Weisbrod, 1997) and high demand for transparency and accountability (Salamon, 1999), managing external relations becomes especially important (Balser and McClusky, 2005). If external relations are not managed effectively, NPOs may end up losing valuable external resources such as volunteers and donations as well as their legitimacy (Ospina *et al.*, 2002, Alexander, 1998).

In Figure 2, knowledge flows between the three IC components and its value increases when it is used. Thus IC assists non-profit managers to balance the utilisation and usage of the existing and unborn intellectual resources. This becomes important to NPOs in particular in today's highly competitive non-profit environment. Table 1 provides examples of value creation through the interaction of IC components.

Insert Table 1 here

The IC conceptual framework provides several strategic advantages to NPOs. Firstly, the framework emphasises the stocks and flows of knowledge within and outside the organisations in order to maximise value creation. External new knowledge comes into individual IC component one at a time or simultaneously. The knowledge flows from one IC component to the others before it is transformed into value to NPOs; that is to reconcile the commercial objectives and social mission in the organisations.

Secondly, the framework provides non-profit managers, employees, volunteers and other stakeholders with a better understanding of strategic directions and, consequently, leads to better strategic decision making for NPOs. Thirdly, the core value is placed at the centre of the model. This enables people in NPOs to direct their energy towards the same organisational goals. As argued by Letts, Ryan and Grossman (1999), having the mission and values truly shared is the biggest challenge in NPOs. This IC conceptual framework therefore helps to achieve a strategic alignment between organisational strategy and value creation in NPOs. Finally, the framework emphasises the importance of external knowledge input and the significance of internal knowledge divestment.

These strategic advantages within the IC conceptual framework help to create a learning culture within NPOs by realising the value of acquiring new external knowledge and retaining useful internal knowledge. One could also argue that by creating a culture that assess their status on a regular basis and is willing to divest itself of outdated knowledge is more willing to accept change. This implies a greater flexibility within the organisation to adapt to crisis or new opportunities. As a result, this learning culture will enable them to better deal with new challenges.

As IC by its nature involves tacit knowledge (Bontis, 1996, , 1998, Department of Industry Science & Resources, , 2001), it is therefore notoriously difficult to quantify

(Roos *et al.*, 1997) as tacit knowledge is often “non-verbalised, or even non-verbalisable, intuitive, unarticulated” (Hedlund, 1994, p.75). For testing the proposed IC conceptual framework, qualitative research methods such as in-depth, semi-structured interviews are suggested which is believed to suit an exploratory study like this one most.

Conclusion and implications

This paper takes an exploratory step applying IC as a strategic advantage conceptual framework in NPOs. The IC conceptual framework offers non-profit managers a clear and more holistic understanding of the role of IC and the interrelationships between the three IC components. Through the IC components, non-profit managers are enabled to better conceptualise the strategic significance of their organisation’s intellectual resources and knowledge management activities. As IC embraces a comprehensive viewpoint of both internal and external aspects of intellectual resources that are embedded in the personnel, organisational routines and network relationships (Bontis, 2002), the IC conceptual framework offers a more completed picture of their organisation’s capabilities. Thus the concept of IC is important to NPOs because it enables non-profit managers to better understand the internal and external issues in the non-profit sector. In short, IC assists NPOs to gain strategic advantage by reconciling their commercial objectives and social mission.

Biographical notes: Eric Kong is a Lecturer at the School of Commerce, Charles Sturt University, Australia. He is also a Ph.D. candidate of strategic management at Monash University. He received his MSc in Quality Management from the University of Paisley and Postgraduate Diploma in Training from the University of Leicester. He is working on his Ph.D. after 10 years of practising human resources in the private sector. His research interests include intellectual capital, knowledge management, non-profit management, strategic management and governance.

Endnote:

¹According to the International Classification of Non-profit Organisations (ICNPO) (Australian Bureau of Statistics (ABS), 2002), social services include child welfare, child services, and day care; youth services and youth welfare; family services; services for people with disabilities; services for the elderly; and self-help and other personal social services.

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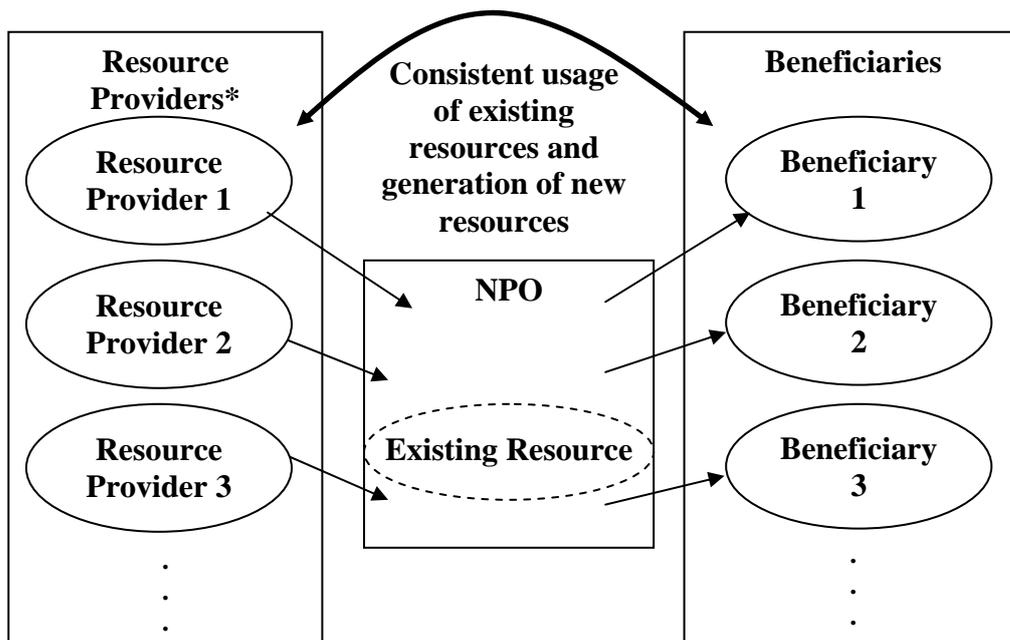


Figure 1 – Resource Acquisition and Utilisation in a NPO

* Resource providers may include government grants, corporate and individual donations, volunteer supports and any other form of tangible and intangible resources from any provider

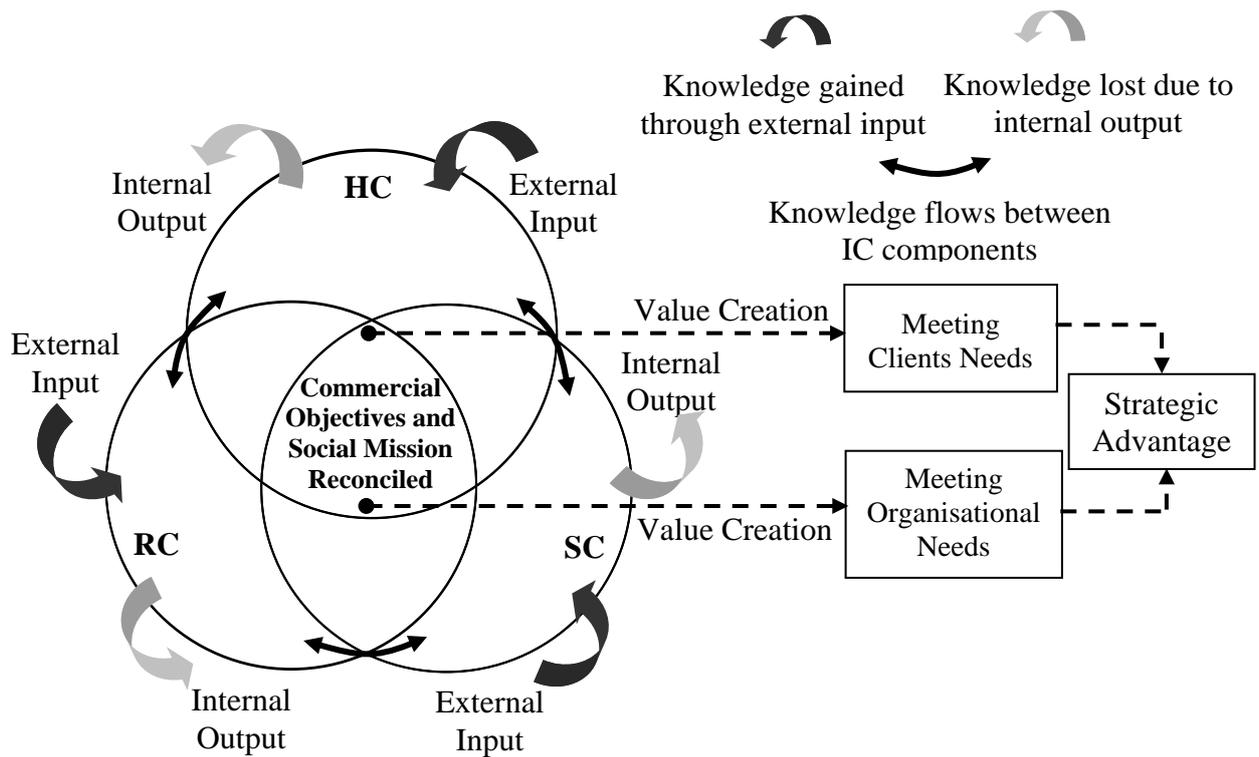


Figure 2 – An IC Conceptual Framework and Strategic Advantage in NPOs
 (Adapted from Kong, 2006)

Table 1 – Examples of Value Creation through the Interaction of IC Components

Knowledge transfers from HC to RC	Knowledge transfers from RC to SC	Knowledge transfers from SC to HC
<ul style="list-style-type: none"> ▪ Non-profit staff members present research papers on behalf of their organisation at international seminars/conferences ▪ Non-profit staff members are encouraged to rotate jobs in order to meet customers/suppliers 	<ul style="list-style-type: none"> ▪ Client and donor profiles are input into system databases ▪ Clients/Donors fill in organisational survey/questionnaire 	<ul style="list-style-type: none"> ▪ Newly recruited non-profit staff members familiarise internal organisational policies/manuals ▪ Existing non-profit staff members analyse client profiles in order to understand client needs
Knowledge transfers from RC to HC	Knowledge transfers from SC to RC	Knowledge transfers from HC to SC
<ul style="list-style-type: none"> ▪ Non-profit Staff members conduct face-to-face survey to clients ▪ 24-hour online enquiry available to the public 	<ul style="list-style-type: none"> ▪ A NPO makes organisational information publicly available in their organisational website ▪ Organisational publications/newsletters are sent to clients/donors 	<ul style="list-style-type: none"> ▪ Senior management formulates organisational strategic plans ▪ Non-profit staff members prepare training manuals for newly recruited employees or volunteers